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Treasury and IRS Release Final Regulations on Direct Pay

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The Inflation Reduction Act of 2022 added Section 6417 to the Internal Revenue Code of 1986, as amended (the "Code"). Under this new section, certain taxpayers may make an elective payment, which will treat certain eligible taxpayers as making a payment against their federal income tax liability in lieu of claiming certain energy tax credits (such election, a "Direct Payment Election"). Tax-exempt entities, state or local governments, and other specified taxpayers may make a Direct Payment Election for all applicable tax credits. Other taxpayers are eligible to make a Direct Payment Election with respect to some or all of the tax credits available under Sections 45Q (carbon capture credit), 45V (clean hydrogen production credit), and 45X (advanced manufacturing production credit).

On March 5, 2024, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") released [final regulations](#) on direct payment of tax credits under Section 6417 of the Code ("Final Regulations") in addition to [proposed regulations](#) under Section 761(a) of the Code allowing certain unincorporated organizations, such as state and local governments and Indian Tribal governments, that are organized exclusively to produce electricity from certain property to elect out of the partnership tax rules (the "Proposed Regulations").

I. Direct Payment of Applicable Credits: Final Section 6417 Regulations

Treasury and the IRS had [previously issued proposed regulations](#) under Section 6417 of the Code and adopted most of the positions taken in the proposed regulations in the Final Regulations except the following changes and clarifications:

A. Applicable Entities

Under Code Section 6417, only "applicable entities" may make a Direct Payment Election with respect to certain tax credits. Code Section 6417(d)(1)(A)(i) defines "applicable entity" as including "any organization exempt from the tax" imposed by subtitle A. The Final Regulations clarify that "any organization exempt from the tax" includes organizations exempt from tax imposed by subtitle A by reason of subchapter F of Chapter 1 of the Code. Thus under the Final Regulations, organizations exempt from taxation under Section 501 (such as Section 501(c)(3) tax-exempt nonprofit entities) through Section 530 of the Code would qualify as "applicable entities" that are eligible to make Direct Pay Elections.

In addition, the Final Regulations expand the consolidated group rules to provide that for members of a consolidated group of which an applicable entity is the common parent, any member that is an electing

taxpayer may make an elective payment election with respect to applicable credits determined with respect to the member. The Final Regulations also clarify the definition of an Indian tribal government to adopt the most recent list published by the Department of the Interior in the Federal Register as the correct list of Indian tribal governments that qualify as applicable entities. In addition, the Final Regulations clarify that "rural electric cooperatives" means any corporation operating on a cooperative basis that is engaged in furnishing electric energy to persons in rural areas as described in Section 1381(a)(2)(C) of the Code.

B. Amended Returns

Direct Pay Elections must be made on an original tax return filed not later than the due date (including extensions of time) for the original return for the taxable year for which the applicable credit is claimed. The Final Regulations clarify that this original return requirement means that taxpayers may not make a Direct Pay Election for the first time on an amended return, withdraw on an amended return or make or withdraw by filing an administrative adjustment request under Code Section 6227. In addition, taxpayers may not correct an item left blank on the original return but may correct any "numerical errors" on an amended return or by filing an administrative adjustment if the original return and election contained all the required information and the elective payment election was properly claimed. The Final Regulations also allow for an automatic six-month extension under Treasury Regulations Section 301.9100-2 from the due date of the return (excluding extensions) to make the election to provide relief for taxpayers who file by the due date of the return.

C. "No excess benefit" rule

The Final Regulations clarify that the determination of whether a grant is a restricted tax exempt amount is generally made when the grant is awarded. A grant awarded after acquisition of the property is a restricted tax-exempt amount if approval of the grant was perfunctory and the amount of the grant was virtually assured at the time of application. Similarly, whether a loan is a restricted tax exempt amount (including whether the loan is intended to be forgiven) is generally determined when the loan is approved. In addition, the Final Regulations clarify that this "no excess benefit" rule does not apply if the tax exempt amount is not received for the specific purpose of purchasing, constructing, reconstructing, erecting or otherwise acquiring a property eligible for an investment-related credit.

D. Pre-Filing Registration Requirements

The Final Regulations clarify that a valid registration number must also be included on any required completed source credit forms with respect to the applicable credit party.

E. Other Changes

- The Final Regulations clarify that IRS Form 1120 can be used to make the Direct Pay Election.
- The Final Regulations amend the definition of "disregarded entity" to be consistent with Treasury Regulations Section 301.7701-1(a)(3).
- The Final Regulations clarify that if an applicable entity or an electing taxpayer amends its tax return or files an administrative adjustment request to properly adjust an excessive payment amount, then the excessive payment provisions of Code Section 6417(d)(6) do not apply.
- The Final Regulations clarify that if a taxpayer normally is not required to file an annual tax return with the IRS (such as the District of Columbia and any U.S. territory), then the taxpayer

may choose to file Form 990-T based upon a calendar or fiscal year in lieu of filing an annual tax return with the IRS.

II. Electing out of the Partnership Tax Rules: Proposed Regulations

Under the Final Regulations, partnerships are not “applicable entities” and thus are not eligible to make any Direct Pay Elections. Therefore, any partnership making an elective payment election must be an “electing taxpayer” and the only applicable credits for which the partnership could make an elective payment election would be under Code Sections 45Q, 45V and 45X. The June 2023 proposed regulations on Code Section 6417 state that if an applicable entity is a co-owner in an applicable credit property through an organization that has made a Code Section 761(a) election to be excluded from application of the partnership tax rules under subchapter K of Chapter 1 of the Code, then the applicable entity’s undivided ownership share of the applicable credit property would be treated as a separate applicable credit property owned by the applicable entity. The applicable entity could make an elective payment election for the applicable credit or credits determined for that share of the applicable credit property.

Code Section 761(a) enables the Secretary of the Treasury, at the election of all members of an unincorporated organization, to exclude the organization from the application of all or part of subchapter K if members’ income can be adequately determined without computation of the partnership’s taxable income and the organization exists: (1) for investment purposes only and not for the active conduct of a business, (2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or (3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities. In addition, an unincorporated organization seeking subchapter K exclusion to allow one or more members to make a Direct Pay Election must also meet the following requirements: (1) the organization’s participants own the property as co-owners, either in fee or under lease or other form of contract granting exclusive operating rights (the “co-ownership requirement”); (2) the participants reserve the right separately to take in kind or dispose of their shares of property produced, extracted, or used; and (3) the participants do not jointly sell services or the property produced or extracted.

Under the current co-ownership requirements, interests in the property of an electing unincorporated organization must be owned directly by its members. The Proposed Regulations revise the current regulations under Code Section 761(a) to allow members of an unincorporated organization to own the applicable credit property through an organization that is an entity (other than an entity treated as a corporation under the Code).

The Final Regulations and the Proposed Regulations are welcome additional guidance which provide additional clarity to certain market participants looking to take advantage of the Section 6417 direct payment option.

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